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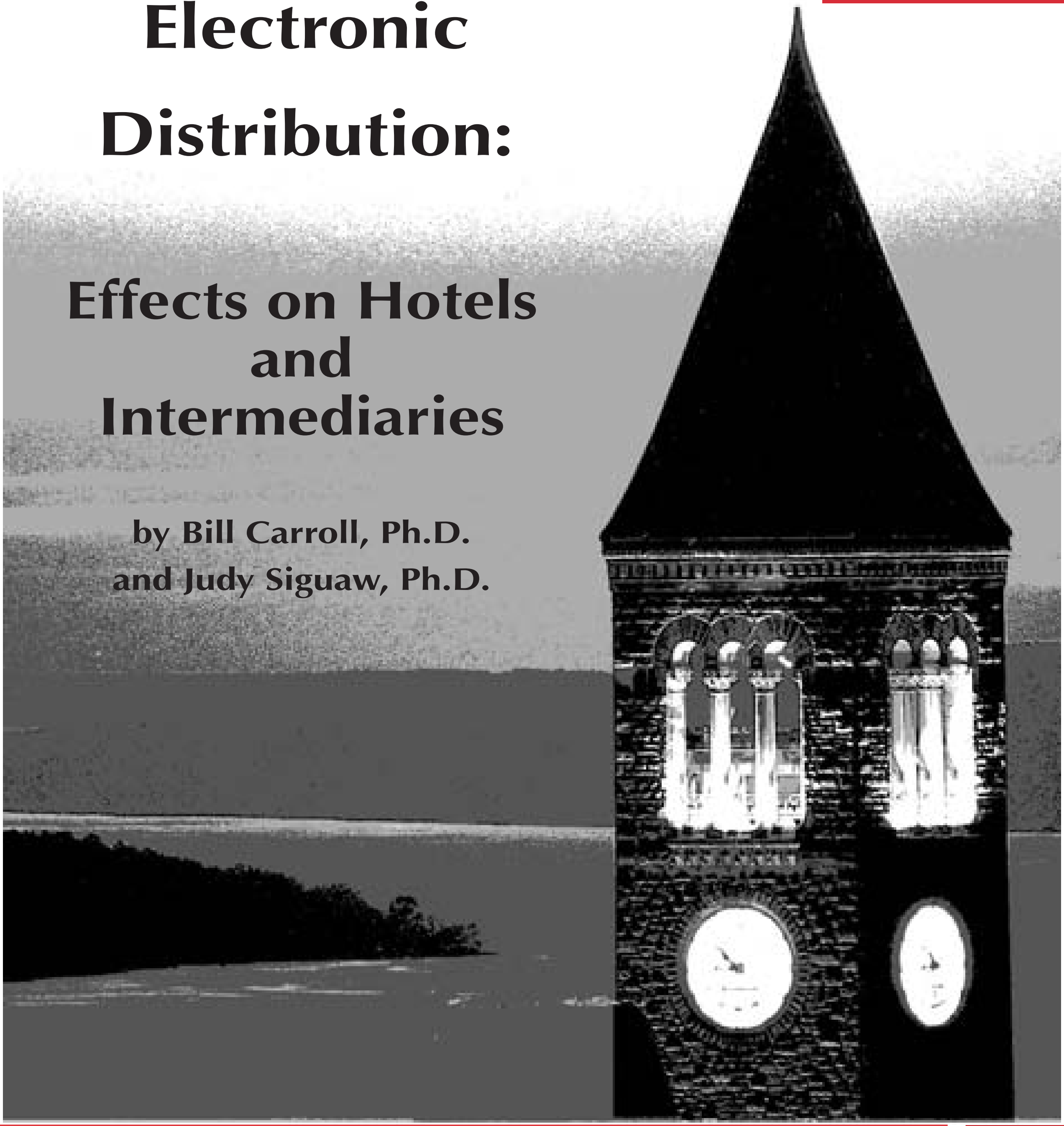
Effects on Hotels and Intermediaries

by Bill Carroll, Ph.D.
and Judy Siguaw, Ph.D.



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by Bill Carroll, Ph.D., and Judy Siguaw, Ph.D.

With the migration of hotel–room distribution to the internet, a host of players old and new are vying to gain (or retain) control of distribution channels. In addition to the hotels and chains themselves, the operations that distribute hotel rooms include global distribution systems (GDSs), distribution service providers (DSPs), third-party websites (e.g., Expedia, priceline.com), and traditional travel agencies. Many of these channels use price as a principal parameter. Hence, a strategic problem for hotels is to avoid having price be customers' main (or only) consideration for a room booking. One chief way to offset the trend toward commoditization is to provide customers with considerable information to distinguish properties based on their provision of services.

While hoteliers seek to drive bookings to their own proprietary websites, the third-party sites (notably, Expedia) have created strategic approaches to encourage hoteliers to distribute rooms on their sites. As a practical matter, hoteliers almost always use some kind of discounted distribution to clear their inventory of unsold rooms. To gain hotel-room listings, some intermediaries, such as travel agents and GDSs, have developed a value-added strategy of providing additional services to their customers and packaging hotel rooms as part of travel packages. One reason that travel agencies have become so interested in distributing hotel rooms is the demise of airline commissions. All intermediaries are attempting to provide services or incentives to encourage customers to book through their channel. One competitive advantage that third-party intermediaries can provide is to shift market share toward a particular hotel or chain.

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Evolution in Electronic Distribution:

Effects on Hotels and Intermediaries

by Bill Carroll, Ph.D., and Judy Siguaw, Ph.D.

HOTEL-DISTRIBUTION CHANNELS ARE UNDERGOING DRAMATIC CHANGES BECAUSE electronic distribution of room information, prices, and availability has changed the way that hotel properties and chains, global distribution systems (GDSs), distribution-service providers (DSPs), wholesalers, travel agents, and travel planners interact with their vendors and customers. In particular, reservation traffic is shifting from travel agents and call centers to individual customers and corporate travel planners who use online intermediaries and direct links to suppliers. Consequently, as shown in Exhibit 1 (next page), electronic distribution-channel options constitute a complex web of choices through which suppliers and buyers of hospitality services must carefully navigate to ensure favorable transaction results.

This report first discusses the various players in the rapidly evolving landscape of electronic distribution, and then examines the factors driving the changes. Next, the strategies being employed by the various players are examined as they seek control of the electronic-distribution channels. Finally, some key implications for hotel and distribution-industry executives are explored.

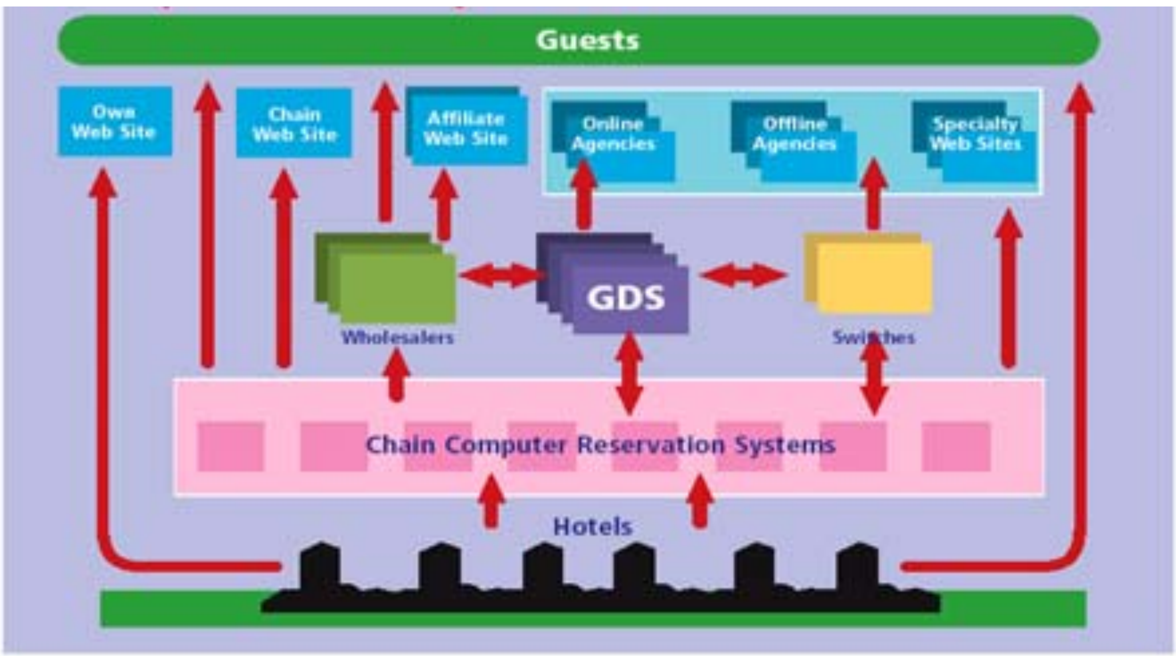
The Emerging Dominance of Electronic Distribution

Spurred by the internet, electronic hotel distribution is increasingly user intimate, screen oriented, and content rich. This form of distribution makes booking hotel services more efficient and responsive than are the former telephone-based approaches. Consequently, by 2005 an estimated 1 in 5 hotel bookings will be made online, up from 1 in 12 in 2002. Online intermediaries will capture about half of those bookings, while hotel chains' websites will control the other half. Most of these online bookings will be made by leisure and unmanaged business customers.[1]

Evidence further suggests that for every booking made online, there are a corresponding number of bookings that are based

[1] *Hotel and Lodging Commerce 2002–2005,* PhoCusWright Inc., November 2002.

Exhibit 1
Hotel-room distribution channels



on internet research but are made via a call to a travel agent, a central reservation center, or the hotel property. Hotel-chain executives have told us that up to 20 percent of customers who look at the chain's website end up calling the chain's reservation center to make a booking.[2] Similarly, among online travelers (those who traveled by air in the prior year and used the internet in the prior month), 55 percent looked online but booked offline.[3] Business travelers looking to manage travel costs and improve their travel experiences are turning to the internet (or an intranet when their company uses one). That strategy places travel choices directly in the hands of travelers and travel planners, who operate according to specific travel budgets and policies. Various estimates suggest that online corporate (managed) travel in the United States will be $18 billion in 2003 and $33 billion by 2005.[4]

Electronic-distribution Competitors

The firms that compete in electronic distribution are internet-based companies, GDSs, distribution-service providers, travel agents, and the hotel chains themselves.

Internet companies. Internet-based travel-distribution intermediaries like Hotels.com, Travelocity, Hotwire, and

[2] Based on structured interviews with senior eight hotel chain senior executives, June 2002.

[3] PhoCusWright, Inc., *Consumer Travel Survey*, March 2003. An online traveler is defined as someone who has taken a trip via air within the last year and has used the internet within the last 30 days.

[4] Max Starkov and Jason Price, "Are Hoteliers Ready to Meet the New Challenges in Online Business Travel?," *HITEC Online*, March 12, 2003; and PhoCusWright, *Online Corporate Travel 2001–2003*, January 2002, Ch. 3.

priceline.com are revolutionizing the way customers choose and book hotels. Six years ago none of these companies existed. In 2001 Expedia was the eighth largest travel agency in the United States.[5] Together with Hotels.com, Expedia accounts for over 70 percent of online hotel bookings not made directly with the property or through hotel chains.[6]

Hotel chains. Hotel chains increasingly use their own web sites, in concert with other marketing and sales efforts, to drive hotel information delivery and online bookings. Marriott reported that in 2002 over 75 percent of their online bookings were done through their website and that they had invested over $1 million in site improvements.[7]

Global-distribution systems. GDSs are repositioning themselves to become marketing and service companies for their suppliers and subscribers (i.e., other intermediaries, principally travel agencies); changing their focus from airlines to other travel-industry segments; and leveraging their strong near-term cash positions to purchase or partner with other intermediaries to provide end-to-end links between end users and suppliers. Their online connection is through their support of other intermediaries, plus mergers, acquisitions, and partnerships with selected online players. Objectives and approaches differ among the four GDSs, and their evolution is still in flux.

Travel agencies. Traditional travel agencies (sometimes called "brick and mortar" agencies) are also transforming themselves. Faced with reduced or eliminated airline commissions, agencies are consolidating and increasingly turning to charging fees for service to travelers and firms. Facing financial pressure, they are increasingly using the internet as a cost-saving and service-extending tool. They are replacing commissions with incentive payments from suppliers, including hotels, for shifting market share.

Distribution-service providers (DSPs). Distribution-service providers include large companies (e.g., Pegasus) and relatively small firms (e.g., Wizcom and Trust International). DSPs provide switches that link hotel CRSs with GDS and online sites, commission- and fee-payment services, representation services, and PMS services. Other companies, such as GetThere and Highwire, provide services to travel agencies and businesses that facilitate travel management and enforce travel policies. Finally, a set of DSPs (e.g., TravelCLICK and Leonardo) provide specific targeted services, such as competitive information and content management. These firms are searching for niches or partnerships that ensure viability in the evolving hotel-distribution environment.

While hotel chains increasingly use web sites to acquire online bookings, a host of channels are attempting to draw consumers to their own sites.

Marketing and Customer-relationship Management

Participants in electronic distribution channels are using the internet to change the way they interact. Because the internet allows intermediaries and hotels to identify who is using the system, they can, with users' permission, be more intimate in communications, transactions, and information gathering. Hotels and intermediaries can tailor sales and marketing efforts to the users' specific needs or search criteria.

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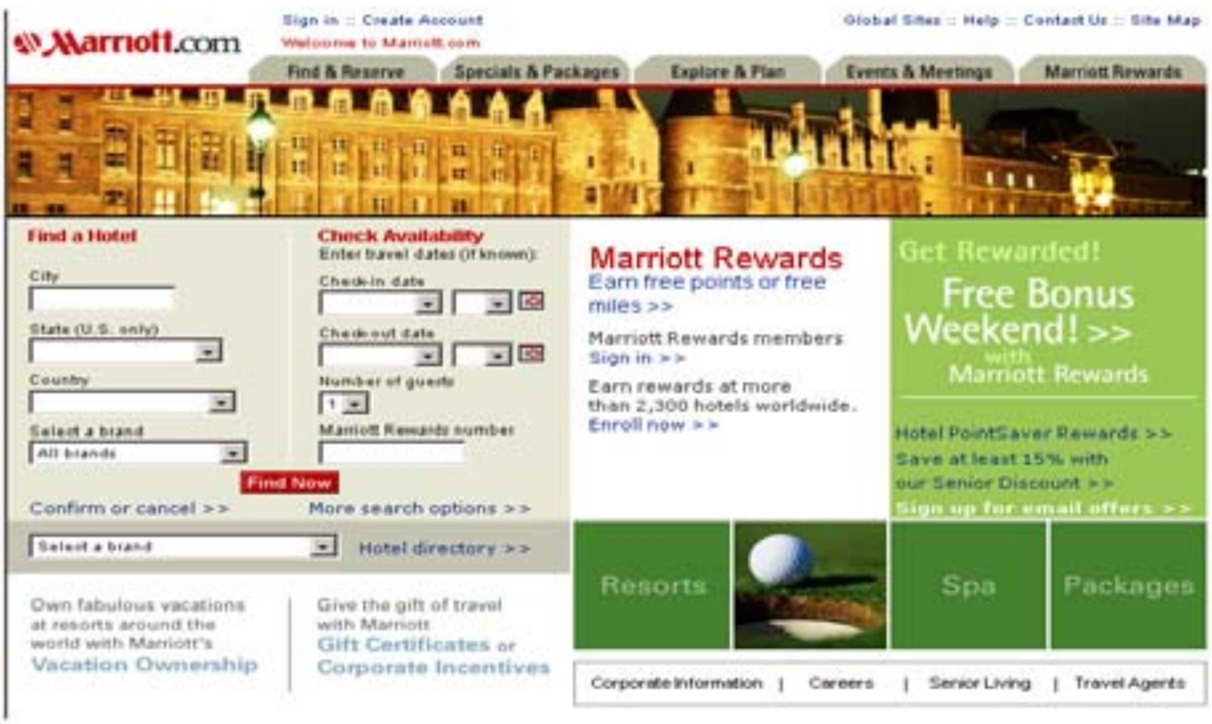
[5] Top 50 Travel Agencies Survey, Travel Weekly, May 2001.

[6] *Hotel and Lodging Commerce 2002–2005*, p. 5.2.

[7] Jorge Sidron, "Marriott.com Posts Sales Record," *Travel Weekly*, February 24, 2003.

Exhibit 2

Marriott.com's home page



System functionality allows users to target information searches, make choices, and efficiently execute transactions. These actions can be effected directly by the user or in concert with a hotel reservations center or a travel agency's call center. Marriott.com's home page, for instance (shown in Exhibit 2), allows users to easily find and book a hotel or to visit other pages where they can:

- book special offers for weekends and weekly getaways, including packages with air fare and car rental;
- search for activity-based holidays such as golf and spa services at Marriott properties;
- manage Marriott loyalty points; and
- search and evaluate Marriott meeting sites and facilities, including associated planning tools and requesting a proposal from Marriott.

Marriott.com also offers a full set of similar tools designed for use by travel agents.

Offering a broader portfolio of travel services, Expedia's site allows users to search for and book flights, hotels, cars, and cruises independently or combined with one another in user-designed packages (see Exhibit 3). Expedia also offers special-interest packages for golf, spa, romance, and weekend getaways. The site promotes last-minute offers and provides such traveler services as weather, currency exchange, and directions.

Hotels, hotel chains, and intermediaries increasingly retain information about their customers to enhance service and improve marketing and sales efforts online. Encouraging customers to manage their loyalty-program points on the website is one way that hotels do this. Some travel agencies

Exhibit 3

Expedia's home page

Exhibit 4

Highwire's services to business clients

Exhibit 5

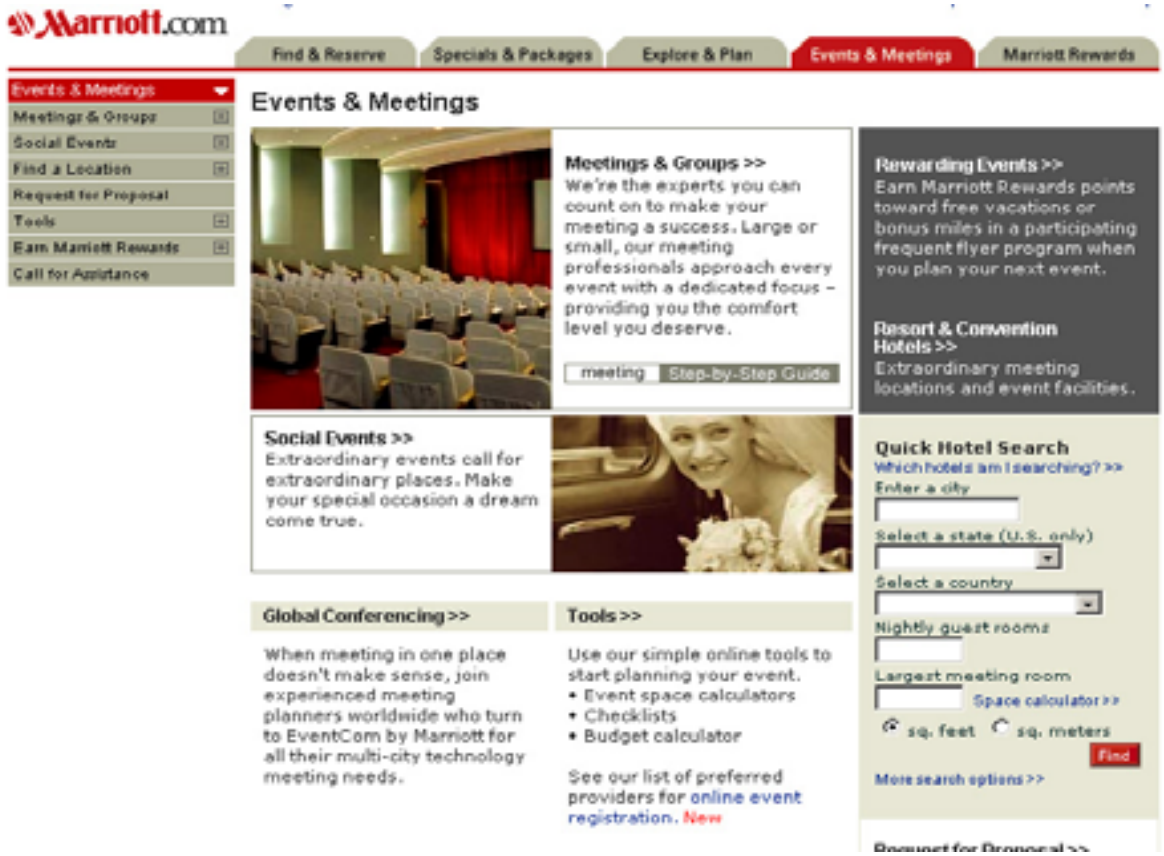
Site59's customer-registration page

assist their business customers by providing individualized, end-user-oriented travel-planning and -management applications. Services of those kinds help clients manage travel costs, enforce travel policies, and support individuals' travel planning and booking. The applications ensure that business travelers select corporate-preferred chains and participate in pre-negotiated hotel-rate programs. Companies like Highwire and GetThere provide applications and other support for travel agencies so that they can provide travel-management services of this kind. See Exhibit 4 (previous page) for a description of Highwire's services to business clients.

Going a step further, travel intermediaries use customer-preference information to offer tailored packages and content displays to encourage bookings and to improve look-to-book ratios. For example, Site59, a last-minute weekend-getaway site, allows the user to register for e-mail updates on various experience-oriented getaways (see Exhibit 5). Additionally, travel and meeting planners use the websites' on-screen tools to make choices about facilities and services. In addition to providing information, the websites facilitate planners' decision-making and help them manage their events (see Exhibit 6 for Marriott's online services for meeting planners).

Exhibit 6

Marriott.com's meeting-planners page



Economic Incentives for Shifts in Distribution

Without doubt, economics is driving many of the changes in electronic distribution, as we explore next.

Hotels and chains. Hotels and hotel chains are using electronic distribution to reduce costs by shifting transactions from intermediaries to their own facilities through direct connections and websites. This saves intermediaries' fees, such as travel-agency commissions of 5 percent to 10 percent and GDS fees of $3 to $5 per transaction. The hotels also gain some call-center productivity when web-informed callers reduce the number of information-only calls and cut the length of booking calls.[8]

Besides producing cost savings, electronic distribution enhances customer retention. For business customers, this means effective corporate-traveler programs—typically offering reduced rates based on anticipated volume in connection with a hotel's reduced distribution costs. For leisure and unmanaged business customers, chains promote loyalty programs with their websites, employ a portal strategy, and use internet-based marketing to encourage

[8] Based on structured interviews with senior eight hotel chain senior executives, June 2002.

customers to visit their site and choose their brand rather than a competitor's. For event planners, hotels assist with improved facility selection and meeting management. Not only does that encourage brand loyalty, but failing to offer such functionality may put the chain at a competitive disadvantage.

Online Travel Agencies and Wholesalers

Intermediaries also have an economic incentive to shift distribution. The motivating factor for intermediaries is the desire to extract more revenue from both hotels and customers.

Expedia, for instance, has taken an industry-leadership position in deriving revenue from hotel-distribution displays and transactions. From September 2000 through August 2002 Expedia's mix of revenue from hotel bookings increased from less than one-third to over 60 percent.[9] Online wholesaler Hotels.com, which like Expedia is a subsidiary of USA Networks, grew revenue by 70.4 percent for the nine months ending September 2002 over the same period in 2001.[10] That dramatic revenue growth for both firms came primarily from hotel reservations. Each gives users access to low- (or the lowest) price rooms online, along with the ability to compare properties and prices for selected destinations. Both negotiate net rates from hotels with mark-ups in the range of 20 percent to 30 percent.

To accomplish their net-rate-with-markup strategy, both Expedia and Hotels.com offer incentives for hotels to be price competitive. when negotiating net rates.

To accomplish their net-rate-with-markup strategy, both Expedia and Hotels.com offer incentives for hotels to be price competitive when negotiating net rates. Hotels.com, for instance, sorts its default screen display based on ascending price. This creates the incentive for properties to offer Hotels.com a low net rate so that those properties appear at the top of the list on the first screen. In Expedia's case, appearing higher in default displays and having the opportunity to display richer content is based on the benefits Expedia obtains in negotiations. Both approaches represent an implicit charge for display and positioning.

Priceline.com and Hotwire have similar wholesale programs. For closely located and classified properties, both offer or display the property with lowest (net) price. Priceline.com also offers the lowest net rates (highest markup) in response to users' bids. Hotwire displays only one property per location and hotel class—presumably, the one that offered Hotwire its best net rate. In fall 2002 Travelocity implemented a program similar to Expedia's.

Global distribution systems. GDSs currently account for an estimated 15 percent of hotel revenues.[11] They, too, are evolving in the way they display information and derive revenue from hotel distribution. Their user base of traditional travel agents is declining along with their erstwhile primary revenue source, airline fees. To sustain revenues, the GDSs, (namely Sabre, Galileo, Amadeus, and Worldspan) are turning to hotel bookings and the provision of services to their travel-agency base. The GDSs are expanding their activities to include ownership and alliances with online agencies. Sabre, for instance, owns Travelocity and

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[9] Expedia.com, "Investor Relations," *Financial Reports*, Fiscal Year 2002.

[10] Security and Exchange Commission Filing: Hotels.com, Quarter Ending September 30, 2002.

[11] *Hotel and Lodging Commerce 2002-2005*, p. 4.10.

GetThere, the business-oriented site. Galileo is owned by Cendant, which also owns Trip.com and Cheap Tickets, both consumer-direct portals; Highwire, a business-oriented, online travel agency and service provider; and Lodging.com, an online hotel wholesaler. Amadeus owns OneTravel.com, an online wholesaler; e-Travel, a business-oriented online agency; and several online leisure-oriented agencies. Worldspan, the smallest GDS, has taken an alternative tack, however. It has shunned expansion as a distributor and aims to be "a travel-technologies services company."[12]

In addition to expanding their activities, the GDSs are improving their ability to influence hotel bookings through their displays. Sabre introduced Sabre Exclusives in 2002, a program similar to Expedia's, which allows hotels to appear high up on the list presented to travel agents by giving Sabre favorable net rates. Sabre marks up those net rates by 20 percent to 40 percent to its travel-agent subscribers. Sabre retains the residual revenue after waiving the booking fee and paying the agency a commission for the hotel.

With the Sabre Exclusives markup, hotel chains actually pay a relatively high price to get a prominent display position. It would cost the hotel more to agree to a net rate with a 20- to 40-percent markup than it would to provide the same rate itself or to offer that rate through a traditional travel agency. That calculation works as follows. Say that a hotel wants to sell a two-day booking at $125 per day. If the hotel sells that booking directly it nets roughly $250 (less negligible variable costs). If sold through a travel agent, that booking would net $222 ($250 less a 10-percent commission—$25—and a transaction fee of $3). If the same booking (that is, a $125 daily rate) is sold using Sabre Exclusives with a 30-percent markup, the hotel chain would take in $192.30, because the net rate provided to Sabre would have to be $96.15 per day.

Despite the economics behind that calculation, the question arises of whether a hotel can afford not to participate, provided it wants to distribute rooms via Sabre. The GDS's display shows the Sabre Exclusives properties first, even if their rates are higher than the rates for the same rooms listed in Sabre by the properties themselves. It's fair to say that the hotel chain is paying for enhanced positioning through that program.

The actual amount of revenue received by an individual property through wholesale programs like those of Sabre, Expedia, and Hotwire cannot be easily determined by outsiders. The amount of net revenue depends on the financial arrangements between chains and their properties, deals negotiated between the chains and the wholesalers, and whether the properties are dealing directly with the wholesalers or through their chains. If a property deals directly with an online intermediary and is able to by-pass financial payments to the chain (e.g., through a reservations-based fee structure), wholesaler economics can be better for the property than is the hypothetical calculation we gave above.

Further muddying the matter of revenues and markups, some wholesalers (and online agencies) have a strategy that calls for increasing the number of properties listed on their site. That entails dealing with the chain rather than with individual properties. If the wholesaler feels that it can increase the number of properties or reduce its sales cost, it might be inclined to negotiate a better deal for the chain than it does for individual properties. Again, such confidential deals make it difficult to determine the economics of property-level distribution. As a final point, the dynamics among properties, chains, and wholesalers are placing

[12] According to Paul Blackney, CEO of Worldspan, PhoCusWright Executive Conference, 2002, November 16, 2002.

Exhibit 7

Rosenbluth International's home page

pressure on chains to demonstrate their value to properties relating to wholesaling and distribution—thus further roiling the negotiations picture.

While the other GDSs have not followed Sabre's lead in promoting a pay-for-position approach, they are acutely aware of their transaction and distribution value to hotels. For example, Cendant now offers end-to-end service from switches (e.g., Wizcom and Trust International) through Galileo to Cendant's online leisure portals (Trip.com, CheapTickets, and Lodging.com) and its travel-agency service, Highwire. As well, Cendant supports a traditional off-line call center, Trilegiant. With a vertically integrated distribution network, Cendant is able to offer multi-faceted deals to hotels and chains that integrate end-to-end distribution. Deals are brokered based on Cendant's ability to shift share, reduce distribution costs, and generate revenue at lower margins than competitors can offer.[13]

Traditional travel agencies. Even traditional agencies are looking for ways to exploit the internet, grow their share of revenues from sources other than airlines, and implement alternative-pricing schemes. Unlike the online agencies and wholesalers, traditional agencies' objective often is not to sustain growth and profits so much as simply to survive the loss of airline revenue.

The enormity of the travel agents' difficulty is shown in the changes in airline

[13] According to Michael McCormick, Executive Vice President, Hospitality and Leisure Services, Cendant Travel Distribution March 31, 2003.

commissions, the agencies' former revenue mainstay. In 1999 domestic-airline revenue was 53 percent of travel-agency revenue. In 2001 that figure had dropped to 45 percent—a 15-percent drop in two short years—and airlines have continued to diminish their commission payments.[14] To build other revenue sources, agencies started charging user fees for many transactions, and also sought increased fees and commissions from hotels, cruises, and travel packages. To earn override commissions, the largest agencies and consortia are offering to shift their considerable customer base from one supplier to another, including hotel chains. Some mega-agencies (notably Carlson Wagonlit) have actually begun to take inventory risk (for instance, buying wholesale cruise cabin inventory) to get lower net rates from suppliers and then using their sizeable market reach to sell that inventory at retail.[15]

Along that line, large travel agencies, such as American Express and Rosenbluth, maintain their own websites. As with other websites, these are intended to enhance service delivery, reduce costs, and retain business. They allow clients to make a booking online; search for a weekend getaway; plan a vacation; or obtain information about a destination and its attractions, restaurants, and entertainment venues. Exhibit 7 shows the sort of information and functionality available on the Rosenbluth site.

Challenges and Competitive Strategies

To counteract the intermediaries' attempts to control distribution channels, hotel chains are enhancing and promoting their own websites; managing access to low-price inventories; and shifting viewership and transactions to their own distribution channels. For example, Choice, Cendant, Starwood, and Six Continents have programs that reward customers with the lowest rate for booking on their sites instead of those of intermediaries.[16]

Five major chains—Hilton, Hyatt, Marriott, Six Continents, and Starwood—have joined with Pegasus to form TravelWeb, an online booking engine that will offer the lowest online rates and serve as quasi-switch for single-image wholesale inventory. By being a portal that can accept higher net rates than will its competitors, TravelWeb places pressure on margins sought by companies like Expedia and Hotels.com. TravelWeb, acting as a portal and through its affiliates, can offer prices plus terms and conditions that are more favorable than those offered by competitors. Further, acting as a quasi-switch, they could facilitate single-image inventory management across all portals.

The enormity of the travel agents' difficulty is shown in the plunge in airline commissions, the agencies' former revenue mainstay.

In principle, TravelWeb is a good idea for its partner hotel chains. The question is whether the benefits will outweigh the costs to promote, develop, and maintain this site and infrastructure against well-established and well-funded online intermediaries. As well, TravelWeb is made up of arch-rival hotel chains that must cooperate in the development and promotion of the enterprise.

Distribution challenges for properties. Individual properties face two major chal-

[14] *Travel Weekly 2002 Travel Industry Survey*, August 2002.

[15] "Carlson Wagonlit to Manage Risk Inventory," *Travel Weekly*, November 7, 2002.

[16] Motoko Rich, "Hotels Offer Price Guarantees to Undercut Travel Sites," *Wall Street Journal*, March 12, 2003.

lenges from electronic distribution: **(1)** control over price and availability and **(2)** the management of website content. To maintain price control, properties and the chains that operate them must structure rates effectively; apply terms and conditions to avoid dilution and arbitrage; monitor competitiveness; and manage rate accuracy and availability.

The chief problem with pricing is that internet searches have made pricing structures nearly transparent. With a few key strokes and no training, a motivated consumer can search for the lowest rate for hotel accommodations at a specific location (or at several locations) and for a specified quality level. The consumer is then free to book through the site of her or his choice—and not necessarily the one where the low price was first discovered. Alternatively, the customer (or his or her agency) can compare the rates being offered at third-party sites to some pre-negotiated, brand-specific corporate or group rate; compare those rates to the prices listed on the chain's or property's own website; and, finally, call the property or chain directly to negotiate an even lower rate.

The chief problem with controlling room rates is that internet searches have made pricing structures nearly transparent.

That same transparency applies to rate competitiveness. All the major sites allow users to sort hotel properties in low-to-high price displays for a specified location and quality level. In such displays, uncompetitive pricing is immediately visible and results in two negative outcomes for the hotel. First, it probably loses the booking to a competitor, and (worse) a high price structure gives a long-term impression of uncompetitiveness for the property or the brand. In such an environment, competitiveness, consistency, and accuracy of rates displayed and made available via multiple channels must be managed effectively.

Resisting commoditization. Perhaps the greatest threat from electronic distribution is the risk that consumers will come to view hotel services as commodities to be purchased only according to price. This fate befell the airline industry when its operators started competing almost solely on price—with consequences still being felt today. Far from being a commodity, hotel service involves many dimensions—among them, the cleanliness and appointments of guest rooms, lobby ambience and space, and on-property services. If hotels can promote these dimensions through their websites (or through those of third-party intermediaries), that information can influence choice.

Our review of major chains' websites and those of major online agencies shows that the industry is well aware of this principle. The sites we examined make extensive use of information and multi-media displays to create a full and differentiated picture of the hotel experience. As with pricing and availability, chains and properties must effectively manage the content on their branded displays, as well as those posted by intermediaries. Although no solid evidence exists, it's fair to posit that inaccurate or uncompetitive displays will affect consumers' choice. At least that's the way it appears to industry executives.[17]

Wholesaling goes mass market. One of the more recent and, perhaps, most problematic pricing issues for hotel properties is the development of online mass wholesaling. Hotels have used wholesaling for many years, mostly with selected operators and locations. Expedia, Travelocity, Hotwire, Hotels.com, and, most notably,

[17] A fruitful area for future research is measuring the return to travel suppliers of accurate displayed and positioned content in online displays.

priceline.com have taken the practice to a mass market.

Because it is a great threat to maintaining ADR, mass wholesaling in its many forms must be carefully managed by the industry. While mass wholesaling may be a necessary, market-clearing evil in an occupancy downturn (or a cunningly designed intermediary strategy), both the margins and the extent of e-wholesaling need to be controlled. The chief problem with mass wholesaling is the transparency of pricing that we just discussed. Customers will inevitably discover large differences between wholesale and other (retail) rates—encouraging arbitrage and diluting rates in the absence of appropriate rate fences.

Wholesaling is insidious. Intended to steal customers from competitors, it works only as a short-term tactic. As the practice spreads and competitors participate, the potential for creating incremental revenue diminishes. A long-term, problematic aspect of mass wholesaling is the danger of commoditization that we just discussed. Certainly, the internet has the potential to deliver visually rich and personalized content. If the message that consumers receive is essentially a "price-only" message, however, the value-added aspect of hotel selection is compromised. Moreover, customers will use those low, wholesale-driven prices as their benchmarks for future pricing expectations.

The challenge for hoteliers is to employ both the value and price aspect of hotel selection, even if they are forced into wholesaling. Hoteliers need to drive users to their own websites. When hotels must wholesale their inventory, they should favor wholesalers that offer value-adding options—Expedia, for one. Expedia is implementing media-rich, expanded-content displays coupled with increased flexibility in inventory and net-rate management. Its displays allow individual properties to show multiple rates that include extensive information (to explain the differences in the rates). It will be interesting to see whether the same intermediaries who copied Expedia's earlier straightforward wholesaling will replicate its broadened, value-based displays.

Unmanaged business: The new battleground. Properties, chains, and intermediaries all have their sights set on the unmanaged business segment, comprising business travelers who have their expenses reimbursed by the firm, but are not subject to formal travel policies (or are covered by policies that are not enforced). This segment represented 11 percent of travelers in 2000, or an estimated $20.5 billion in travel spending in 2003.[18]

Both online and traditional travel agencies see opportunities in providing travel-management services to unmanaged-business clients. As well, they see opportunities for using the internet (or an intranet). Agencies can generate additional user-fee revenue by providing cost-saving services and improving margins by offering favorable supplier deals for their unmanaged business clients. Intermediary services include: **(1)** the enforcement or the reporting of travel-policy compliance; **(2)** management of travel to preferred suppliers and pre-negotiated (reduced) rates; **(3)** comparison of (private) negotiated rates with public rates to find the lowest price; **(4)** use of rates negotiated with preferred suppliers; and **(5)** provision of support services for travelers. For the client these services can provide savings, convenience, and improved control over travel expenses.

To the extent that the internet (or an intranet) is used for self-booking, and direct links are provided to suppliers, further savings are possible. Agencies and suppliers often charge reduced fees for self-booked

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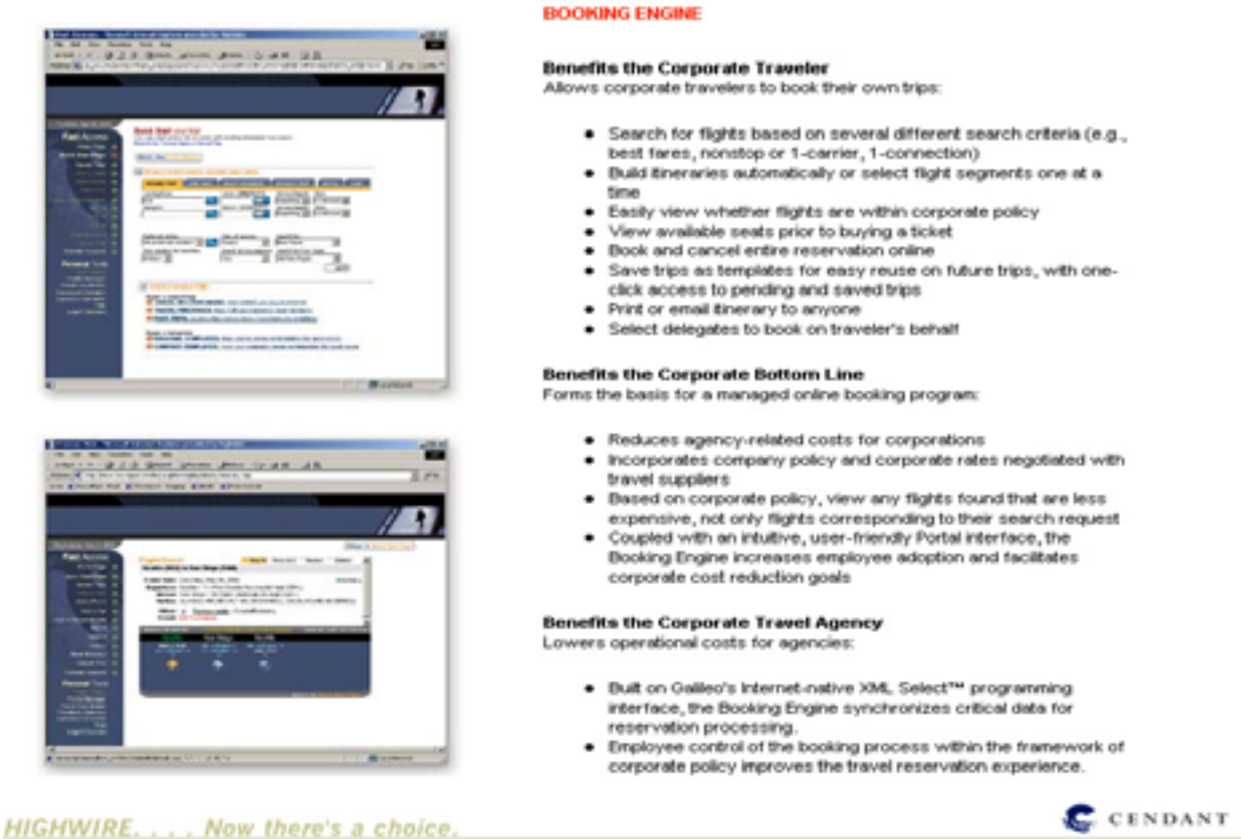
[18] PhoCusWright, *Online Corporate Travel 2001 – 2003,* January 2002, Ch. 3.

Exhibit 8

Highwire's booking benefits



reservations, cancellations, and changes. (See Exhibit 8 for the benefits Highwire ascribes to using its booking engine.)

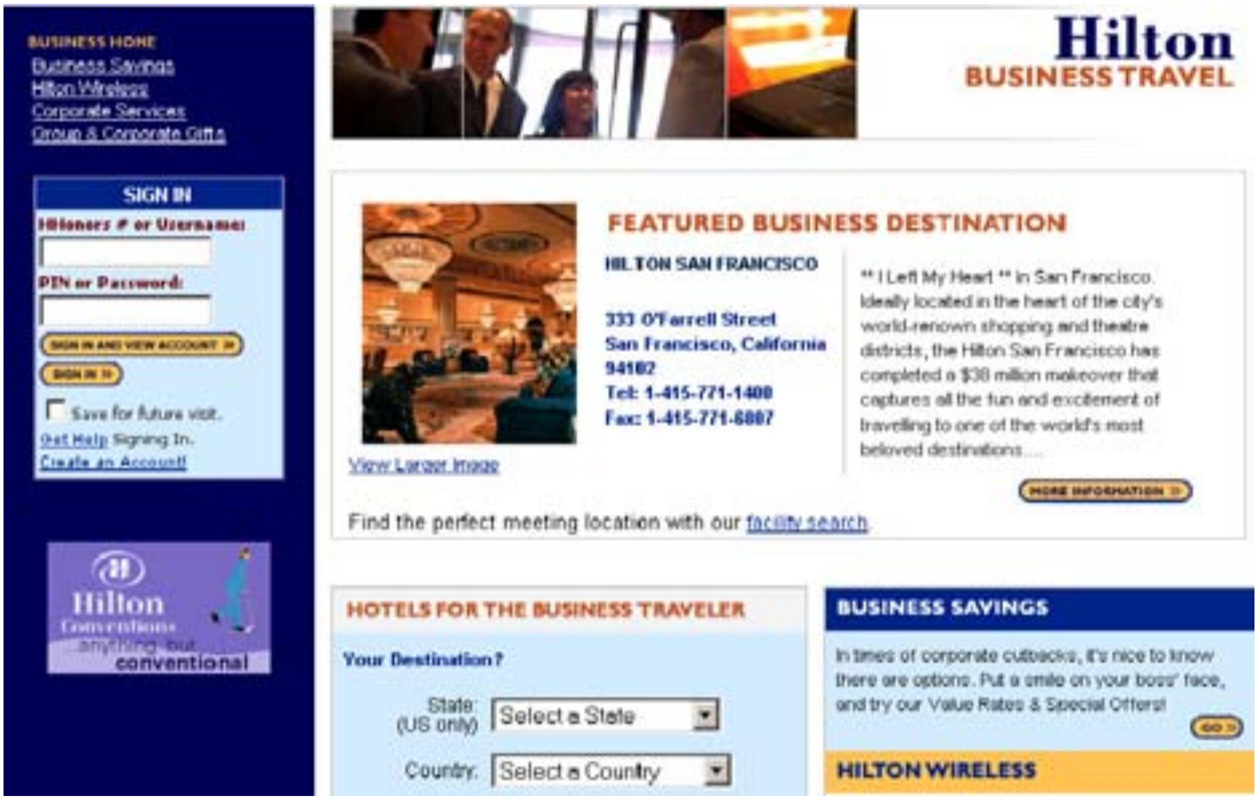
Advantages for the unmanaged business traveler and travel planner are mixed. On the one hand, agencies provide applications that: **(1)** allow travelers to plan, book, and change their itineraries (within travel-policy guidelines), **(2)** produce online (always available) travel reports, **(3)** generate on-the-spot expense reports for travelers, and **(4)** provide online support for travelers (e.g., detailed maps and destination information). On the other hand, the traveler or travel planner gives up the convenience of having a live travel agent handling all the arrangements. Despite the savings and potential advantages of online travel management for the business client and his or her agency, the adoption rate (the percentage of eligible travelers who use the internet in this way) has not been astronomical (although it has increased). The rate is currently estimated at 20.3 percent.[19]

Hotel chains also see the unmanaged-business segment as a target. Rates charged to this segment are likely to be higher than are those offered to large corporate accounts. In soliciting the unmanaged traveler, chains see the obvious benefit of winning

[19] *Ibid.*

Exhibit 9

Hilton's page for business travelers



business from the competition. Finally, by encouraging direct booking, chains avoid intermediary payments and, over time, create a loyal relationship with the client or business traveler. Chains such as Hilton have specifically designed their sites to offer advantages and services for this target segment. See Exhibit 9 for Hilton's web pages designed specifically to attract and serve the business client.

Looking Ahead

Based on our review of trends in electronic distribution, we see the following occurrences on the horizon.

(1) Expect hotel chains, the GDSs, and (perhaps) TravelWeb to challenge the current major online retailers and wholesalers. Hotel chains will continue to invest in their own websites and offer direct links to selected customers and wholesalers.

(2) As the economy (and demand) improves, rising occupancy will reduce the markups required by wholesalers, along with the need for wholesaling in general. For actual rate increases, the individual property managers will have to take action based on individual market realities—as has occurred in past recoveries.

(3) While hotels will continue to be successful at building business on their websites, growth will not come at the expense of online travel agencies. Leisure travelers prefer having the wide the property selection available through third-party online retailers.

(4) Hotels' commission payments to intermediaries will give way to pay-for-performance programs aimed at shifting market share and providing other value-added services.

(5) Chains will challenge travel agencies and GDSs on service and sales to the small and medium-size enterprise market as a way to continue growing.

(6) As distribution becomes increasingly complicated, hotels will gain experience in effectively managing price, availability, content, media, and display positioning in many distribution channels. New DSPs will emerge, and existing companies (e.g., Pegasus, Wizcom, and Trust International) will expand their services to help properties and chains implement their goals. Armed with sophisticated information and enjoying the rising occupancy that accompanies a recovering economy, hotels will slowly but steadily gain improved (but never complete) control over their pricing and inventory. ■

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